

July 13, 2023

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Via Email: Standards@theiia.org

Dear Mr. Pugliese

Re: Response to IIA Exposure Draft – Global Internal Audit Standards 2023

In my capacity as Chair of the International Ethics Standards Board for Accountants (IESBA), I would like to congratulate the IIA on its project to comprehensively review and update the International Professional Practice Framework (IPPF), including the *International Standards for the Professional Practice of Internal Auditing*.

The internal audit function, alongside the finance office, plays an important role within organizations as the frontline of defense in protecting the integrity of an organization's financial and non-financial information in the public interest. Therefore, amongst their other responsibilities, it is crucial that internal auditors adhere to high standards of ethical behavior.

By way of background, the IESBA is an independent global standard-setting body that serves the public interest by setting robust, internationally appropriate ethics standards, including auditor independence requirements, for professional accountants worldwide. The [International Code of Ethics for Professional Accountants \(including International Independence Standards\)](#) (the IESBA Code) is a cornerstone to ethical behavior in business and organizations, and to public trust in financial and non-financial information that is fundamental to the proper functioning and sustainability of organizations, financial markets and economies worldwide.

The IIA has been an important stakeholder to IESBA, providing valuable input to its standard-setting work, particularly through the IIA's long-standing involvement as a member organization of the IESBA Consultation Advisory Group (CAG). Both our organizations share a common commitment to set a high ethical bar for professionals who are responsible for ensuring the integrity and reliability of financial and non-financial information disclosed by organizations.



With input from the IESBA's Planning Committee, I am pleased to share the following comments on the proposed Global Internal Audit Standards (IIA Standards), focusing on the ethics requirements set out in the Ethics and Professionalism (E&P) domain of the proposed Standards.

General Comments

Overall, I commend the IIA's efforts in making the proposed IPPF clearer and easier to navigate in order to meet the changing needs of the internal audit profession and the ever-changing environment that are impacting the functions of these practitioners. I agree that it is an important strategic priority and in the public interest to ensure international standards such as the IIA Standards and the IESBA Code remain fit-for-purpose and relevant in addressing key issues users of the standards face.

Incorporating the Code of Ethics, currently one of the elements in the IPPF, into the Ethics and Professionalism (E&P) domain of the proposed IIA Standards helps to reinforce the relevance and centrality of ethics in the work of IA professionals. I also consider the structure of the proposed IIA Standards of stating the requirements, followed by considerations of implementation and evidence of conformance (including the application to public sector internal auditors), to be a helpful way for users to more practically consider how to comply with the principles-based requirements in the proposed Standards.

I recognize that the key concepts set out in the IESBA Code's five fundamental principles (FPs) are generally embedded within the principles set out in Section 2 of the proposed IIA Standards, albeit in different ways. I agree that these principles in the IIA Standards form the ethical foundation upon which internal auditors should build their ethical behavior. Although the IESBA Code does not elevate the FP of integrity to be the foundation for its other four FPs, I support the view that integrity is fundamental to maintaining a high standard of ethical behavior.

In this regard, I am pleased to observe that the principle of integrity in the proposed IIA Standards contains some of the key concepts that were added to the IESBA Code as part of the IESBA's "Role and Mindset" project. The concepts of having courage and taking actions, particularly when facing dilemmas or difficult situations, are important components of acting with integrity as ethical behavior in those circumstances can only be demonstrated by actions. I am also pleased to observe that the principle of integrity in the proposed IIA Standards captures the importance of organizational ethical culture as well as the role of internal auditors in promoting such culture. Similar concepts are embedded in Part 1 of the IESBA Code to highlight the role of professional accountants, particularly those in leadership, in contributing towards an ethical organizational culture.

I also note that the IIA's principle of "exercising due professional care" requires, amongst other things, the "application of professional skepticism to critically assess and question information." In this regard, the IESBA has recognized the importance of having a critical mindset when assessing information. The IESBA has therefore introduced the concept of "having an inquiring mind" in Part 1 of the IESBA Code as part of its "Role and Mindset" project.

I would like to highlight below three aspects (conceptual framework, use of the term "independence" and definition of professional skepticism, and additional guidance) for the IIA's consideration.

Conceptual Framework

The design of the IESBA Code is based on a “building blocks approach, with Part 1 of the Code set up as the foundational block. Part 1 sets out the conceptual framework and includes overarching principles-based requirements that apply to all professional accountants. Material in Parts 2, 3, 4A and 4B of the Code is premised on the user’s proper understanding of Part 1.

As set out in Section 120 of the IESBA Code, a professional accountant is required to apply the conceptual framework to identify, evaluate and address threats to the Code’s FPs. In this regard, the Code has identified five specific categories of threats: self-interest threat, self-review threat, advocacy threat, familiarity threat, and intimidation threat.

To apply the conceptual framework, a professional accountant is required to (1) have an inquiring mind, (2) exercise professional judgment, and (3) use the reasonable and informed third party (RITP) test. The Code also provides further guidance in Part 1 on what each of these three components means. The use of such a comprehensive ethics framework is key to successfully applying the IESBA Code to address ethics issues. This is because the IESBA Code is principles-based and does not prescribe actions for every ethical dilemma a professional accountant might face when conducting a professional activity.

I note that such a framework is not employed within the proposed IIA Standards. For instance, the proposed Standards do not provide guidance to an internal auditor on how they would identify threats to the ethics principles or apply potential safeguards that could reduce the threats to an acceptable level. Whilst the term “professional judgment” is used throughout the proposed IIA Standards, the proposals do not provide any guidance on the term or how it should be applied. Further, the use of the RITP test is also not a concept included in the proposed IIA Standards. I believe that without a systematic approach such as the IESBA Code’s conceptual framework, it may be less effective for internal auditors to apply the IIA Standards to comprehensively address specific ethics issues.

Therefore, I encourage the IIA to consider the IESBA Code’s conceptual framework and whether it could provide a comprehensive framework to assist internal auditors to identify, evaluate and address threats to the principles set out in the proposed IIA Standards when performing their internal audit functions.

Use of the terms “Independence” and “Professional Skepticism”

The proposed IIA Standards have used two common terms that are strongly linked to the performance of external audits of financial statement, namely “independence” and “professional skepticism.”

Independence

The independence of audit firms is crucial to public trust in external audits of financial statements. The independence requirements set out in Parts 4A and 4B of the IESBA Code, as well as the definition of “independence,” have been adopted widely by national standard setters, regulators and audit firms across the globe because of the robustness of these standards in setting a high bar of independence for external auditors. The IESBA Code defines “independence” as:

- (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and

- (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm’s, or an audit or assurance team member’s, integrity, objectivity, or professional skepticism has been compromised.

The proposed IIA Standards defines “independence” as “The freedom from conditions that impair the ability of the internal audit function to carry out internal audit responsibilities in an unbiased manner”. Principle 7.3 of the proposed IIA Standards states the responsibilities of both the board and the chief audit officer in ensuring the independence of the internal audit function and Standard 2.2 requires that an internal auditor performing and supervising an engagement should be independent from the activity under review.

Although the proposed IIA Standards’ definition of independence highlight the need for the work of the internal audit function to be carried out in an unbiased way, I am concerned that the use of this well-established term outside the context of an external audit of financial statements may be problematic. In particular, the use of the term in the proposed IIA Standards may lead some stakeholders and the public to mistakenly believe that an internal auditor is independent of the entity in the same sense that an external auditor is independent of the audit client.

I therefore recommend that the IIA consider using a term other than “independence” to convey the intended meaning, for example, “impartiality.”

Professional skepticism

Principle 4 in the proposed IIA Standards (Exercise due professional care) requires, amongst other things, the “application of professional skepticism to critically assess and question information.” In this regard, the proposed IIA Standards define “professional skepticism” as “Questioning and critically assessing the reliability of information.” Whilst I am supportive of the proposed IIA Standards requiring the exercise of a critical mindset, I have some concerns that the term “professional skepticism” is used to describe this mindset.

The concept of professional skepticism is most prominently dealt with in standards addressing the performance of external audit and assurance engagements. The IESBA Code identifies that under auditing, review and other assurance standards, including those issued by the International Auditing and Assurance Standards Board (IAASB), professional accountants are required to exercise professional skepticism. The IAASB’s International Standard on Auditing (ISA) 200 defines professional skepticism as “an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.”¹ As part of the information gathering on the IESBA’s “Role and Mindset” project, the IESBA heard a strong view from stakeholders that the term “professional skepticism” should be reserved for use only in the context of external audit and assurance engagements, as defined in the auditing and assurance standards issued by the IAASB. Taking stakeholders’ feedback into consideration, the IESBA ultimately developed the concept of “having an inquiring mind” that is applicable to all professional accountants, whether they are auditors, other professional accountants in public practice, or professional accountants in business (PAIBs).

¹ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(l)



In light of the above, and to minimize differences with the definition in the IAASB standards, I recommend that the IIA consider using a term other than “professional skepticism” to denote the critical mindset that is expected of internal auditors when carrying out their activities.

Additional guidance

The proposed IIA Standards address several key ethics issues, such as conflicts of interest and accepting gifts, rewards or favor, that may, or are presumed to, impair objectivity as well as reporting incidents of legal or regulatory violations. The IESBA Code also addresses these issues from the perspective of PAIBs in Part 2 of the Code. In addition to dealing with the application of the conceptual framework, Part 2 sets out additional requirements and application material when PAIBs are facing ethical issues such as conflicts of interest, inducements, and non-compliance with laws and regulations.

For instance, Section 270 of the IESBA Code deals with pressure to breach the fundamental principles of the Code. Amongst other matters, the section requires a professional accountant not to allow pressure from others to result in a breach of compliance with the FPs. It also prohibits a professional accountant from placing pressure on others that would result in the others breaching the fundamental principles. This section also provides extensive examples of pressures under different ethical situations. Such additional guidance material helps guide the judgments and behavior of PAIBs, including those who are internal auditors, when they face ethics issues in carrying out their professional activities.

I therefore encourage the IIA to consider developing additional guidance on the ethical topics addressed in Part 2 of the IESBA Code. Such guidance could either be included in the proposed IIA Standards or developed as non-authoritative material. The IIA may also wish to consider referring its members to the IESBA Code for additional guidance in addressing those ethics issues.

I hope that the IIA finds these comments helpful and constructive. As the IIA progresses its work in finalizing the proposed IIA Standards, the Staff of the IESBA would be pleased to discuss any matters in connection with the IESBA Code that may be of assistance to the IIA. If you wish to discuss any of the above comments, please do not hesitate to contact Geoffrey Kwan, Director, IESBA, at geoffkwan@ethicsboard.org, or me at gabrieladias@ethicsboard.org.

Yours truly

A handwritten signature in dark ink, appearing to read "gabrieladias". The signature is written in a cursive, flowing style.

Gabriela Figueiredo Dias

IESBA Chair